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Securities and Exchange Commission

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RE: The Enhancement and Standardization of Climate-Related Disclosures for Investors

Public Input from the R Street Institute on Proposed Rule for “The Enhancement and Standardization of Climate-Related Disclosures for Investors”

Summary of the R Street Institute

In response to the Commission’s (SEC) request for comment on its proposed rule “The Enhancement and Standardization of Climate-Related Disclosures for Investors,” this document aims to answer several questions offered in the proposal. This response is not an exhaustive response to the Commission’s proposed rule, but instead represents a response to key components of the proposal that we feel are detrimental to both market and environmental outcomes. This response should be viewed neither as endorsement nor condemnation of the Commission’s proposed rule.

The R Street Institute (RSI) is a free market-oriented think tank focusing on market-based solutions to public policy problems. RSI believes in and affirms that strong capacity of private enterprise and freedom of expression through consumer choice are invaluable tools in addressing many public challenges, allowing society to achieve the best outcomes at the least cost. RSI was founded as a direct counterpoint to those who dismissed climate change, and as an institution has aimed to identify and educate on opportunities for market-based policy to address climate change. The Commission’s proposed rule creates an opportunity to enhance market function by furnishing investors with better information regarding their exposure to climate-related risk, and an appropriate standardization of definitions for firms that claim to be offsetting or negating climate-related risk. However, in several aspects, we note that the proposed rule would interfere with markets, obfuscate material information to investors as to climate-related risk and worsen private-sector led emission mitigation efforts.

Question Responses

Question 8. Should we require a registrant to disclose any climate-related risks that are reasonably likely to have a material impact on the registrant, including on its business model or consolidated financial statements, which may manifest over the short, medium, and long term as proposed? If so, should we specify if a particular time period, or minimum or maximum range of years, for “short,” “medium,” and long term?” For example, should we define short term as 1 year, 1-3 years, or 1-5 years? Should we define medium term as 5-10 years, 5-15 years, or 5-20 years? Should we define long-term as 10-20 years, 20-30 years, or 30-50 years? Are there other possible years or ranges of years that we should consider as the definitions of short, medium, and long term? What, if any, are the benefits to leaving those terms undefined? What, if any, are the concerns to leaving those terms undefined? Would the proposed provision requiring a registrant to specify what it means by the short, medium, and long term mitigate any such concerns?

The rule as proposed does not properly define “climate-related risks.” The suggested policy of disclosing the book value of assets in areas vulnerable to the physical impacts of climate change is problematic because merely having assets in a high-risk area does not in and of itself create risk. This is because risk, understood as the probability of event occurrence multiplied by the consequence of event occurrence, must incorporate an understanding of both *probability* and *effect*. The Commission’s approach to assessing the physical climate-related risk is to determine probability by zip-code, and effect by book value, but this approach to risk evaluation fails to acknowledge that registrants are likely moderating their climate-related risk through adaptation and insurance markets.

In our submitted comment last year, we noted that insurance markets are key to mitigating the risk of the physical impacts from climate change because they allow insurance holders to spread risk over a pool of premium holders, and over an extended period.¹ Reinsurers in particular are well suited to identifying the level of physical risk their clients face, and then adjusting the required premium to cover those risks. The price signals from premiums allow firms to weigh the physical risks of climate change against the potential advantages of having assets in an at-risk location. Thus, when a firm has insurance that covers the physical impacts of climate change, their risk is already mitigated and accounted for in their operational costs. The SEC’s proposed disclosure requirement would fail to offer any insight into the actual level of risk to the registrant’s profitability.

While we acknowledge that not all firms have opportunities for insurance—as the proposed rule noted, some insurers have deemed wildfire risks too difficult to insure—the disclosure of insurance status is much more likely to offer material information to investors. We suggest that instead of merely requiring registrants to disclose book value of assets in at-risk areas, the SEC should also require that this information be supplemented with whether these assets are insured against climate-related natural

¹ Philip Rossetti, “Public Input from the R Street Institute on Climate Change Disclosure,” R Street Institute, June 11, 2021, p. 4. <https://www.sec.gov/comments/climate-disclosure/cll12-8906910-244216.pdf>.

disasters, and whether registrants have undertaken steps to harden or adapt these assets against climate-related natural disasters.

The role of the Commission in this case is not to merely tabulate the value of assets that may be in areas vulnerable to coastal flooding, wildfires or other climate-related natural disasters, but rather to give investors a clear view of if firms have properly taken steps to mitigate these risks. The approach as outlined in the proposed rule would create a malformed understanding of risk; as registrants grow or property value increases, registrants would seem to be more at risk to climate-related natural disasters, when they may in fact be becoming more capable and more incentivized to mitigate risk.

We also feel it is important for the Commission to note that climate-related natural disasters are not new phenomena. Climate change is not the cause of natural disasters, but rather a multiplying and exacerbating factor of natural disasters.² The registrants that the Commission seeks disclosure from are, even now, vulnerable to the risks of natural disasters, but climate change increases the likelihood of being impacted by some of these natural disasters. Therefore, the tools of risk mitigation that firms have utilized in the past are still relevant today. Climate change should not be treated as a new or distinct risk. The material need of investors as it pertains to climate change today rather than the past is that the need for insurance, adaptation or other risk mitigation actions are greater now and will be in the future than historically.

The opportunity to mitigate future risk as it relates to the physical impacts of climate change are best formed when forward-looking. A deficiency of existing risk mitigation tools, like insurance markets, is most likely when risk measures only utilize historic data and may not be sufficiently accounting for incrementally increasing risk. It should also be noted that existing regulatory policy may already be forcing firms to account for such risks, and the more useful information is the adequacy and comparability of how firms account for the current policy landscape in their reporting.

The Commission's rule, as proposed, seems to operate under an assumption that registrants are unaware of and unprepared for the physical risks of climate change. This is an improper foundational assumption for policy formulation because investors have always had to acknowledge and account for the risks of natural disasters in their investments.

Question 9. Should we define "climate-related risks" to mean the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as proposed? Should we define climate-related risks to include both physical and transition risks, as proposed? Should we define physical risks to include both acute and chronic risks and define each of those risks, as proposed? Should we define transition risks, as proposed? Are there any aspects of the definitions of climate-related risks, physical risks, acute risks, chronic risks, and transition risks that we should revise? Are there other distinctions among types of climate-related risks that we should use in our definitions? Are

² Rajendra K. Pachauri et al., "Climate Change 2014: Synthesis Report," Intergovernmental Panel on Climate Change, 2014, p. 15.
https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf.

there any risks that we should add to the definition of transition risk? How should we address risks that may involve both physical and transition risks?

The rule as proposed is likely overstating the materiality of registrants identifying transition risks. In our comment last year, we noted then—and continue to affirm—that transition risks are likely a greater source of risk to registrants than physical risks.³ However, there is heterogeneity of transition risks, and registrants also have a limited capability to identify transition risks.

The disclosure of transition risks is most pertinent for firms that are very likely to be regulated under greenhouse gas emission mitigation policies or are already under such policies: oil and gas companies that produce energy and emission intensive products, automobile manufacturers that must comply with Corporate Average Fuel Economy (CAFE) standards and so on. The nature of these transition risks, though, are mitigated by the statutory requirements of the rules being constrained to what is both technologically and economically feasible and able to pass cost benefit analysis.⁴

Climate-related regulations may threaten the profitability of firms, and thus it is material for registrants to estimate and disclose them (as was suggested in our comment). The SEC should acknowledge, however, that it is not reasonable for registrants to presume that such regulations could require total changes in technological state, or that regulations with onerous economic burdens could be legally upheld.

Furthermore, it is important to acknowledge that although the United States has been a party to the United Nations Framework Convention on Climate Change since ratification in 1992, in the 30 years since, the U.S. Congress has never fully passed legislation that would constrain greenhouse gas emissions.⁵ In 2009, the Waxman-Markey legislation, which would have capped greenhouse gas emissions in the United States, passed the House of Representatives but was never taken up in the Senate.⁶ The only other notable attempt to constrain emissions legislatively was the early version of the Build Back Better Act which included the “Clean Electricity Performance Program,” (CEPP) that would have subsidized emission reductions in the electric power sector—which only covers 25 percent of U.S. greenhouse gas emissions—has not passed the Senate, and the CEPP was excised from the bill text before being voted on in the House of Representatives.⁷

Similarly, there is serious uncertainty as to the quality and permanence of proposed regulations, despite *Massachusetts v. EPA* requiring that the Environmental Protection Agency (EPA) regulate greenhouse gas emissions.⁸ The Obama administration’s seminal climate policy, the Clean Power Plan, an EPA regulation under Section 111(d) of the Clean Air Act, was stayed by the Supreme Court in February 2016

³ Philip Rossetti. <https://www.sec.gov/comments/climate-disclosure/cl12-8906910-244216.pdf>.

⁴ Maeve P. Carey, “Cost-Benefit Analysis in Federal Agency Rulemaking,” Congressional Research Service, March 8, 2022. <https://crsreports.congress.gov/product/pdf/IF/IF12058>.

⁵ Treaty Document 102-38, United Nations Framework Convention on Climate Change, 102nd Congress. <https://www.congress.gov/treaty-document/102nd-congress/38/resolution-text>.

⁶ H.R.2454 - American Clean Energy and Security Act of 2009, 111th Congress. <https://www.congress.gov/bill/111th-congress/house-bill/2454>.

⁷ Coral Davenport, “Key to Biden’s Climate Agenda Likely to Be Cut Because of Manchin Opposition,” *The New York Times*, Nov. 3, 2021. <https://www.nytimes.com/2021/10/15/climate/biden-clean-energy-manchin.html>.

⁸ *Massachusetts v. EPA* (No. 05-1120) 415 F. 3d 50. <https://www.law.cornell.edu/supct/html/05-1120.ZS.html>.

a mere six months after the rule had been finalized.⁹ The rule was since revised into the Affordable Clean Energy rule, which essentially imposed no new restrictions on electricity producers, in part because the targets of the Clean Power Plan were met ahead of expectations.¹⁰

Furthermore, most climate policy that would represent transition risk as defined by the Commission has come at the state and local level, through policies such as renewable portfolio standards. The implementation of these policies has been uneven and disparate, oftentimes the result of unpredictable ballot initiatives with as many failed proposals as successful ones. Voluntary action from firms, unencumbered by political processes, often represents the greater level of climate commitment that registrants are likely to navigate.¹¹ There is enormous complexity in all the potential avenues that a registrant may be impacted by transition risk, and we are unsure of a registrant's capabilities to identify and predict transition risk adequately.

Even the nation's best political analysts expecting climate regulation and legislation to be implemented in the United States have consistently been incorrect. So much of climate policy implementation is intrinsic to ultimately unforeseeable transitory social and economic issues that tend to take a higher priority for policymakers. Quite simply, the expectation that all registrants should be able to determine and disclose how transition risk affects their financial operations is unrealistic. Because it is so difficult to know the specifics of transition risk, most of the information likely to be furnished will be of little value, and ironically can worsen understanding of climate risk as material information will be diluted by immaterial disclosure.

We recommend, as we did in our comment last year, that disclosure of transition risks be constrained to registrants or filers that reasonably should expect to be under new regulation (emissions or energy intensive firms, oil and gas producers, manufacturers, etc.).¹² Such firms, which already should be operating under an expectation that regulation on their practices is likely, are best equipped to furnish useful information to investors, and are also the most likely to be impacted by climate-related regulation or legislation. Furthermore, these registrants are more likely to be impacted by foreign regulations that constrain demand for their exported product. There is little value in firms that have only limited exposure to energy-intensive products to estimate transition risk.

Question 18. Should we define climate-related opportunities as proposed? Should we permit a registrant, at its option, to disclose information about any climate-related opportunities that it is pursuing, such as the actual or potential impacts of those opportunities on the registrant, including its business or consolidated financial statements, as proposed? Should we specifically require a registrant to provide disclosure about any climate-related opportunities that have materially impacted or are reasonably likely to impact materially the registrant, including its

⁹ Courtney Scobie, "Supreme Court Stays EPA's Clean Power Plan," American Bar Association, Feb. 17, 2016. <https://www.americanbar.org/groups/litigation/committees/environmental-energy/practice/2016/021716-energy-supreme-court-stays-epas-clean-power-plan>.

¹⁰ Philip Rossetti and Dan Bosch, "What's in a Baseline?," American Action Forum, Sept. 6, 2018. <https://www.americanactionforum.org/insight/whats-in-a-baseline>.

¹¹ Devin Hartman, "Markets are the path to climate optimism," R Street Institute, Nov. 16, 2021. <https://www.rstreet.org/2021/11/16/markets-are-the-path-to-climate-optimism>.

¹² Philip Rossetti. <https://www.sec.gov/comments/climate-disclosure/cl12-8906910-244216.pdf>.

business or consolidated financial statements? Is there a risk that the disclosure of climate-related opportunities could be misleading and lead to “greenwashing”? If so, how should this risk be addressed?

The Commission should not require firms to define or disclose “climate-related opportunities.” This is for two reasons. The first is that the Commission’s understanding of climate-related opportunities, an example of which is the transition to lower cost or cleaner energy, is incomplete. The example given by the Commission of lower cost clean energy is reliant on comparisons of energy costs in a “levelized” manner—that is, the total cost of the energy is divided by the amount of energy produced. Such cost comparisons are, in practicality, useless for comparing costs of energy. This is because electricity is, for the most part, a nondurable good where storage is often more expensive than new generation. The demand for electricity fluctuates throughout the day, but not all resources are able to dispatch at any time. Notably, wind and solar resources are intermittent and variable, with capacity factors typically below 40 percent.¹³ Because these low-cost resources are not always available to supply electricity when it is in demand, it is fallacious to assume that they are always able to offer cost savings.

The United States Energy Information Administration (EIA), the nation’s premier authority on energy economics, explicitly cautions policymakers not to use levelized cost comparisons to formulate policy. In its estimate of levelized cost of electricity (LCOE), the EIA states, “LCOE does not capture all of the factors that contribute to actual investment decisions, making the direct comparison of LCOE across technologies problematic and misleading as a method to assess the economic competitiveness of various generation alternatives.”¹⁴

Analyses that offer estimates of cost savings or economic improvements from global clean energy transitions are, by necessity, simplified in their assessment to offer usable insight to policymakers. For example, assessments of the cost of a transition to clean energy, as was prepared by the National Academies of Sciences last year, made assumptions about the falling costs of battery storage and electric vehicles, but these assumptions do not consider potential mineral constraints that can raise the costs inputs of electric vehicles and energy storage technology.¹⁵ These analyses also conventionally make assumptions about the average costs as representative of an entire industry. For example, the PATHWAYS model—typically used in studies on achieving a clean energy transition—applies cost assumptions universally throughout the economy, even though in reality there are many cases where the availability of one resource or another (as well as needed supplemental assets like transmission for

¹³ Anodyne Lindstrom and Sara Hoff, “EIA expands data on capacity and usage of power plants, electricity storage systems,” U.S. Energy Information Administration, Feb. 28, 2020.

<https://www.eia.gov/todayinenergy/detail.php?id=42995>.

¹⁴ U.S. Energy Information Administration “Levelized Cost and Levelized Avoided Cost of New Generation Resources in the *Annual Energy Outlook 2019*,” U.S. Department of Energy, February 2019.

https://www.eia.gov/outlooks/archive/aeo19/pdf/electricity_generation.pdf.

¹⁵ The National Academies of Science, Engineering, and Medicine, *Accelerating Decarbonization of the U.S. Energy System*, (The National Academies Press, 2021), pp. 41-42 and 101.

<https://nap.nationalacademies.org/read/25932/chapter/4#40>;

<https://nap.nationalacademies.org/read/25932/chapter/5#100>.

electricity) significantly affect the cost and feasibility of fuel type substitutability.¹⁶ These analyses offer useful insight to policymakers as to the scale of the difference between today's economy and how quickly capital stock replacement can occur, but are not suitable for offering prescriptive policy recommendations, because application of average scenario comparisons ignores the large volume of scenarios that do not conform to the average.

The second reason the Commission should not require the disclosure of such opportunities is that registrants are already expected to capture available opportunities to improve their profitability. The rule as proposed by the Commission seems to presume that registrants would either not be aware of or not claim opportunities for lower cost energy or improved efficiency absent the rule. This is a fallacious assumption, and one that can be described as a central planning bias. Profit is in and of itself a sufficient motivator for registrants to take advantage of cost-minimizing behavior, regardless of if the change is related to clean energy, emissions or efficiency. The rule, as proposed, would simply raise the burdens of registrants without any additional benefit. The only scenario in which the rule would induce firms to pursue such "climate-related opportunities" is one in which the Commission is better at identifying opportunities for profit than registrants, which runs counter to our economic understanding of business behavior that prioritizes profit maximization.¹⁷

Question 24. If a registrant has used a carbon offsets or RECs, should we require the registrant to disclose the role that the offsets or RECs play in its overall strategy to reduce its net carbon emissions, as proposed? Should the proposed definitions of carbon offsets and RECs be clarified or expanded in any way? Are there specific considerations about the use of carbon offsets or RECs that we should require to be disclosed in a registrant's discussion regarding how climate-related factors have impacted its strategy, business model, and outlook?

The Commission is correct to point out that the use of carbon offsets or Renewable Energy Credits (RECs) may not offer a complete picture of a registrant's effectiveness in mitigating or offsetting their emission profile. However, we advise that the Commission's disclosure requirement should be constrained to merely stating the volume of RECs and/or offsets purchased, as well as from where they were purchased, and any verification standards associated with such purchases. Imposing strict definitions or qualifications will not result in a framework that ages well, given how dynamic the commercial environment is for the attributes of RECs, carbon offsets and related products with respect to climate impact.

RECs, defined as the generation of a certain volume of electricity from renewable sources, do not offer any insight as to avoided emissions. A REC that represents the displacement of coal generation on the market does offer an emission benefit, but a REC that is produced at the height of the "duck curve" when the market is already saturated with renewable energy generation represents little to no emission

¹⁶ "PATHWAYS Model," Energy and Environmental Economics, Inc., last accessed May 9, 2022. <https://www.ethree.com/tools/pathways-model>.

¹⁷ Tejvan Pettinger, "Profit Maximisation," Economics Help, July 16, 2019. <https://www.economicshelp.org/blog/3201/economics/profit-maximisation>.

benefit.¹⁸ While we applaud firms' efforts to use RECs to negate their carbon footprint, the fact that most RECs do not have appropriate data on the temporality of their generation and emission displacement means that oftentimes claims of "100 percent renewable energy" are dubious at best and misleading at worst.

Generic RECs also do not account for grid congestion, which determines the marginal generation fuel and associated emissions displaced. Since congestion occurs in a dynamic and spatially granular manner—as in thousands of pricing nodes in a single region adjusting on a sub-hourly basis—fixing the problem requires reform to energy institutions.

Similarly, there are challenges with the utilization of carbon offsets to achieve climate objectives fully. An emission of carbon dioxide can live in the atmosphere for hundreds of years, but the duration for which a ton of carbon dioxide is stored as part of an offset mechanism may not equal this timeframe.¹⁹ This means that the environmental value of the offset may not equal the environmental impact of the emission.

There are also serious concerns as to the quality of carbon offsets and their "additionality," which is to say their ability to produce an environmental benefit that would not have otherwise been achieved (i.e. a carbon offset from an existing tree that would not have been harvested offers no additionality, but the planting of a new tree as a result of carbon offset investment does generate additional benefit).

However, carbon offsets do offer tangible environmental benefits. These offsets represent the real growth and preservation of carbon sinks. Especially important is that carbon offsets create a mechanism whereby firms have an incentive to invest in environmental improvements in foreign nations that may not have policies in place that maximize or encourage environmental conservation and/or emission mitigation.²⁰

Technological improvements are also making possible an improved type of credit, a carbon sequestration credit, which represents "carbon dioxide removal" (CDR) and allows for the complete negation of emissions.²¹ But, at least initially, credits for CDR are likely to rely on the same types of markets and investment initiatives as efforts for carbon offsets.

The rule, as proposed by the Commission, would disincentivize investment and adoption of efforts to promote carbon offsets and CDR. This is because a focus on gross emissions, without considering the impact of offsets, reduces the intrinsic utility of offsets for companies in demonstrating environmental progress. The Commission's proposed rule essentially treats gross emissions as an equivalent to exposure to transition risk, so it makes sense that gross emissions should be the primary consideration. However, because the policy mechanisms whereby transition risk could be manifested are

¹⁸ National Renewable Energy Laboratory, "Ten Years of Analyzing the Duck Chart," U.S. Department of Energy, Feb. 26, 2018. <https://www.nrel.gov/news/program/2018/10-years-duck-curve.html>.

¹⁹ Alan Buis, "The Atmosphere: Getting a Handle on Carbon Dioxide," National Aeronautics and Space Administration, Oct. 9, 2019. <https://climate.nasa.gov/news/2915/the-atmosphere-getting-a-handle-on-carbon-dioxide>.

²⁰ Philip Rossetti, "Economic and Environmental Potential of Carbon Offsets May Be Underestimated," *R Street Policy Study* No. 243, October 2021. <https://www.rstreet.org/wp-content/uploads/2021/10/RSTREET243.pdf>.

²¹ "Carbon Dioxide Removal," Microsoft, last accessed May 9, 2022. <https://www.microsoft.com/en-us/corporate-responsibility/sustainability/carbon-removal-program>.

fundamentally unknowable at this point, it is possible that offsets or CDR credits could be mechanisms for compliance with future climate-related policies as well as investor-driven efforts to discipline emissions. Therefore, a rule that requires the disclosure of gross emissions without consideration of offsets or CDR credits would not produce comparable information about the overall emission and environmental profile of registrants.

We recommend that if the Commission does require registrants to disclose emissions, firms should also disclose the volume of carbon offsets or CDR credits purchased; the source of such credits and verification standards used; and, if RECs are disclosed, the temporality and locality of generation to determine if the RECs resulted in any additional emission mitigation. The information furnished as such would offer much more comparable information from a registrant, rather than a mere comparison of gross emissions, and is less likely to make the Commission's rule a barrier to private investment in environmental improvement. Registrants should be able to claim and show the utility of their environmental investments easily, and the Commission's rules should not be a barrier to such activity nor should it discount the benefits of such investments.

Question 98. Should we require a registrant to disclose its Scope 3 emissions for the fiscal year if material, as proposed? Should we instead require the disclosure of Scope 3 emissions for all registrants, regardless of materiality? Should we use a quantitative threshold, such as a percentage of total GHG emissions (e.g., 25%, 40%, 50%) to require the disclosure of Scope 3 emissions? If so, is there any data supporting the use of a particular percentage threshold? Should we require registrants in particular industries, for which Scope 3 emissions are a high percentage of total GHG emissions, to disclose Scope 3 emissions?

The Commission should not require the disclosure of Scope 3 emissions for several reasons. The first reason is that, as alluded to in the question's phrasing of "regardless of materiality," an attempt by the Commission to force the disclosure of information that is not material to investors is fundamentally outside the scope of the Commission's authority. The responsibility of the Commission is to ensure that investors have access to all material information needed to make informed choices, ensuring that companies do not criminally withhold information that otherwise obfuscates investment risk. If registrants are forced to provide information that is immaterial to investors, it will also ironically diminish the effectiveness of the Commission in its mission as investors will be less able to determine what information is material and what is not. As the Commission notes in its own question, it has not even determined if Scope 3 emissions are material, so requiring their disclosure should not be pursued.

The second reason Scope 3 emissions disclosure should not be required is that the volume of Scope 3 emissions does not in and of itself present a complete view of risk. As we noted earlier, the proposed rule seems to operate under the assumption that there will be constraints on emissions in the future, and thus the mere presence of emission represents a transition risk. This is contrary to reason, though, as we know that some emission-intensive products have *increasing* demand and are expected to have sustained demand through the long term, and in cases where they displace higher-polluting alternatives, they may be less likely to be curtailed by policy or face transition risk. For example, natural gas is an emission-intensive product, but the EIA estimates that natural gas demand will increase globally by 31

percent through 2050.²² President Joe Biden has even promised to increase natural gas exports as part of an energy security strategy to reduce European reliance on Russian energy.²³ Natural gas typically displaces coal, and despite its emission intensity typically results in lower net emissions since it is cleaner than competing energy sources.²⁴

For natural gas, requiring the disclosure of Scope 3 emissions would seem to present a picture that natural gas would come under policy restriction and is a high-risk investment, when in truth the current policy expectations would indicate natural gas may be less likely to face transition risk than competitors that would otherwise be excluded from a Scope 3 disclosure requirement. The rule, as proposed by the Commission, offers no comparable or usable information to investors in this regard, and merely expanding the range of emission sources that would have to comply with disclosure requirements does not change this.

The third reason is that Scope 3 emissions may not represent an enhanced risk for the registrants. For example, the proposed rule notes that Scope 3 emissions would include the commuting emissions of employees, but just because an emission-intensive company, like an oil and gas company, would be required to disclose such emissions under the rule as proposed does not mean that the registrant carries any more or less risk than any other company that has employees commuting in a like manner. The utility of requiring registrants to disclose information like employee commuting emissions seems to offer no usable information to investors at all, since not only are policies that constrain such activity unlikely but competing investment opportunities would be similarly affected.

The fourth reason is that, as noted by the Commission in its proposed rule, registrants likely have little to no experience in estimating Scope 3 emissions. The purpose of the Commission's proposed rule is to improve the comparability of information, but the widely disparate types of registrants that may have to furnish Scope 3 emissions, as well as the manner in which they would estimate these emissions (much of which would be conjectural due to lack of data) means that the disclosed emissions are unlikely to be complete, accurate or comparable estimates of the entirety of how a registrant's business affects emissions. For example, Blackrock stated in February 2022 that it does not consider "scope 3 disclosures and commitments essential to our support for directors" as they view Scope 3 differently from Scope 1 and 2 given methodological complexity, concerns about double-counting and lack of direct control by companies. Double-counting is particularly salient as it could lead to misperceptions of risk among

²² U.S. Energy Information Administration, "International Energy Outlook 2021," U.S. Department of Energy, 2021. <https://www.eia.gov/outlooks/aeo/data/browser/#/?id=2-IEO2021®ion=0-0&cases=Reference&start=2010&end=2050&f=A&linechart=Reference-d210719.75-2-IEO2021&ctype=linechart&sourcekey=0>.

²³ Clifford Krauss, "Europe and the U.S. Make Ambitious Plans to Reduce Reliance on Russian Gas," *The New York Times*, March 25, 2022. <https://www.nytimes.com/2022/03/25/business/energy-environment/biden-eu-liquefied-natural-gas-deal-russia.html>.

²⁴ Selina Roman-White et al., "Life Cycle Greenhouse Gas Perspective on Exporting Liquefied Natural Gas from the United States: 2019 Update," National Energy Technology Laboratory, Sept. 12, 2019, pp. 20-21. <https://www.energy.gov/sites/prod/files/2019/09/f66/2019%20NETL%20LCA-GHG%20Report.pdf>.

investors.²⁵ Reporting of Scope 1 and 2 emissions should indirectly ensure climate risk is accounted for in other firm's Scope 3 emissions.

While we are sympathetic to the Commission's hope that a simple metric such as Scope 3 emissions can serve as a correlative metric for measuring risk, we are unconvinced that requiring such disclosures would do anything more than impose onerous and vague burdens on registrants while furnishing little useful information to investors.

Question 99. Should we require a registrant that has made a GHG emissions reduction commitment that includes Scope 3 emissions to disclose its Scope 3 emissions, as proposed? Should we require registrants that have made any GHG emissions reduction commitments, even if those commitments do not extend to Scope 3, to disclose their Scope 3 emissions? Should we only require Scope 3 emissions disclosure if a registrant has made a GHG emissions reduction commitment that includes Scope 3 emissions?

While we acknowledge that the current state of markets surrounding emission offsetting and mitigation from companies is lacking in high-quality, verifiable information, we do not believe it to be prudent for the Commission to require firms that make pledges to reduce emissions to disclose Scope 3 emissions. While it may be novel to know how effective a company's efforts to reduce emissions are, the information is not material to investors.

A transparent information framework for Scope 3 emissions may help advance societal objectives, but this is not within the scope of the SEC. In fact, requiring the disclosure of Scope 3 emissions from registrants that make pledges to reduce emissions will discourage some registrants from undertaking any new environmental commitments, as it creates additional burdens of costs for privately funded environmental action.

Question 109. Should we require a registrant to disclose the intensity of its GHG emissions for the fiscal year, with separate calculations for the (i) the sum of Scope 1 and Scope 2 emissions and, if applicable (ii) its Scope 3 emissions (Separately from Scopes 1 and 2), as proposed? Should we define GHG intensity, as proposed? Is there a different definition we should use for this purpose?

The Commission's focus on GHG intensity is welcome, as it is this metric which is most likely to offer comparable information among registrants as to their susceptibility to transition risks. However, the Commission's proposed definition of GHG intensity is inappropriate. Transition risks that manifest are most likely to impact a registrant's Scope 1 emissions primarily, and to the extent that they impact Scope 2 emissions, the registrant will not be the primary impacted entity. Presumably, the potential

²⁵ "Climate risk and the global energy transition," BlackRock, February 2022, p. 2.
<https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf>.

transition risk that Scope 2 emissions could relate to would be represented as the Scope 1 emissions of another registrant.

Additionally, the way transition risk may manifest is as a policy that registrants must comply with, such as a regulation on emission sources. These regulations would not consider Scope 2 emissions, but instead would only apply to emission sources, and thus Scope 1 emissions. Regulations that attempt to include Scope 2 emissions from an entity would go “outside the fenceline” and cannot be upheld (i.e. an electricity consumer cannot be the responsible party for an electricity producer’s compliance with the law).²⁶

Furthermore, the proposed metric of GHG intensity relative to revenue offers no functional utility to investors. The revenue of a firm does not affect its likeliness of coming under regulation, and thus its transition risk. For example, recent increases in oil prices mean that oil producers would have lower GHG intensity relative to their revenue, but their transition risk has worsened because higher prices are likely to stymie demand, and policymakers are seeking policies that reduce reliance on oil. The Commission’s proposed definition of GHG intensity would ironically make oil seem less vulnerable to transition risk.

The more appropriate metric is GHG intensity per unit of production. For many firms that are likely to have material risks related to climate change, these units of production are standard (one barrel of oil, one thousand cubic feet of natural gas, one light-duty vehicle, etc.). GHG intensity per unit of production would allow investors to have a clear view of which producers are significantly more or less emission intensive in their production than others, and thus are more or less likely to be disadvantaged by future policies that could constrain those emissions.

III. General Request for Comments

We request and encourage any interested person to submit comments on any aspect of the proposed amendments, other matters that might have an impact on the proposed amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

In our initial comment last year, we noted that the Commission has an opportunity to improve the comparability and quality of climate-related disclosures.²⁷ We noted that there were two types of risk, physical risks and transition risks, and mitigating those risks requires different approaches. For registrants that are likely to be at risk of the physical impacts of climate change, we noted that the most material information to investors would be the level to which their assets are insured, and whether

²⁶ Lawrence Hurley and Valerie Volcovici, “Supreme Court justices question U.S. power to curb carbon emissions,” *Reuters*, Feb. 28, 2022. <https://www.reuters.com/markets/commodities/biden-climate-agenda-faces-us-supreme-court-hurdle-2022-02-28>.

²⁷ Philip Rossetti. <https://www.sec.gov/comments/climate-disclosure/cll12-8906910-244216.pdf>.

insurance is available or deemed too high-risk.²⁸ We also noted that the manifestation of climate risk is heterogeneous, with some firms being materially vulnerable, and others not.²⁹ For transition risks, we noted that they can represent a greater risk to firm profitability than physical risks, but simple requirements for emission disclosure are not likely to be materially useful to investors because merely tabulating emissions does not in and of itself say anything about future product demand and registrant profitability.³⁰

The Commission, in its proposed rule, is making a critical error that is pervasive in its proposal, which is a central planning bias that presumes that emissions *will* be constrained and thus the presence of emissions in and of itself entails a transition risk. This is a fallacious approach to policymaking. As we noted earlier in this comment, the understanding that GHG emissions should be constrained by policy dates back to the 1990s, and at every presented opportunity the U.S. government has failed to implement any firm constraint on emissions. Current climate policy in the United States is primarily driven by narrow industry-specific regulations, many of which are overturned in court, and subsidies for clean energy-related technologies. The highest-quality forward-looking energy analyses available from the EIA for both domestic and international energy demand show long-term reliance on emission-intensive fuels.³¹ The Commission's proposed corollary of transition risk is entirely premised upon a major global transition away from GHG emitting products for which, by all indications, there is no evidence to describe if, when or how such might occur beyond hypothetical transition scenarios.

We would encourage the Commission to understand that, fundamentally, it does not know to what extent if or how emissions will be constrained in the future, and as such gross emission disclosures are unlikely to offer much insight as to transition risks.

As it pertains to emission disclosure, we note that GHG intensity is the most usable metric, though the Commission should adjust its definition to focus on GHG intensity of production, since GHG intensity of revenue offers no utility in comparing the likelihood of products to face transition risk.

We also would encourage the Commission to appreciate that its proposed disclosure requirements will impose new requirements on any firm seeking to reduce their emissions, which may implicitly disincentivize privately funded emission mitigation. Currently, firms pursue these environmental gains because they are of value to brand credibility, but imposing new requirements on these actions may discourage new action and create a system in which large companies that can more readily comply with the Commission's rules will be able to pursue environmental action that is beneficial to their brand, while smaller registrants will be unable to comply with the Commission's rules. Such a framework may risk distorting competitive relationships within and between industries irrespective of climate risk, while

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ibid.

³¹ U.S. Energy Information Administration, "Annual Energy Outlook 2022," U.S. Department of Energy, last accessed May 9, 2022. <https://www.eia.gov/outlooks/aeo/data/browser/#/?id=2-AEO2022®ion=1-0&cases=ref2022&start=2020&end=2050&f=A&linechart=~ref2022-d011222a.123-2-AEO2022.1-0~ref2022-d011222a.132-2-AEO2022.1-0~ref2022-d011222a.145-2-AEO2022.1-0~ref2022-d011222a.143-2-AEO2022.1-0~ref2022-d011222a.142-2-AEO2022.1-0&map=ref2022-d011222a.4-2-AEO2022.1-0&ctype=linechart&sourcekey=0>.

creating greater risk of “regulatory capture,” whereby instead of improving economic outcomes, the regulation instead serves as a policy that shields incumbent firms from competition.³²

Moving forward, our suggestions for the Commission are as follows:

- In terms of physical risks, the Commission’s proposal to utilize zip codes to identify at-risk areas has merit. However, the utility of such information is not merely the presence of asset value in areas that experience physical risk from natural disaster, but also if such assets are insured or unable to garner insurance. Similarly, reinsurance registrants, for whom climate risk is material due to potential impacts on their risk pool, should disclose if there are barriers to offering of reinsurance in certain cases. This information is much more usable to investors in gauging risk because natural disasters are not a new phenomenon, but rather investors will be increasingly interested in the ability of registrants to avoid business impacts from natural disasters.
- Additionally, as it pertains to physical risks, if registrants are required to disclose any potential vulnerabilities to physical risks from climate change, they also should disclose if adaptation has mitigated such risk. A regulatory focus on merely residing in a high-risk area or having a large amount of assets in a high-risk area does not in and of itself convey usable information to investors. Rather, what is most usable is whether the competitiveness or profitability of a registrant is threatened by lack of insurance access or lack of disaster preparedness.
- In terms of transition risks, instead of the Commission requiring the complete disclosure of Scope 1 and 2 emissions for registrants, and then further requiring Scope 3 emissions for select registrants, we recommend that the Commission instead require the disclosure of Scope 1 GHG intensity of product for emission-intensive registrants (oil and gas producers, manufacturers, etc.). Such information allows for comparability of registrants that may provide substitutable products, allowing investors to recognize if some registrants are more or less vulnerable to transition risk.
- The Commission should avoid adopting policies that create major barriers to registrants that seek to offset or reduce their emissions, since such a system will not only fail to yield material information to investors but will also have deleterious effects on the environment as it creates barriers to the nascent industries seeking to increase private sector climate action.

We encourage the Commission to return to its core mission of ensuring that registrants disclose material information to investors and discourage the Commission from attempting to use corollary variables as stand-ins for determining materiality. The heterogeneity of both climate-related risk and registrants mean that large, one-size fits all disclosure regimes may entail high burdens with little benefit. Instead, the Commission should turn to metrics that are more useful for identifying an outsized level of climate-related risks from registrants, focusing on insurance, adaptation and product emission intensity.

Conclusion

The R Street Institute respectfully requests the Commission consider the public input offered herein.

³² Ernesto Dal Bó, “Regulatory Capture: A Review,” *Oxford Review of Economic Policy* 22:2 (2006). http://faculty.haas.berkeley.edu/Dalbo/Regulatory_Capture_Published.pdf.

Respectfully submitted,

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